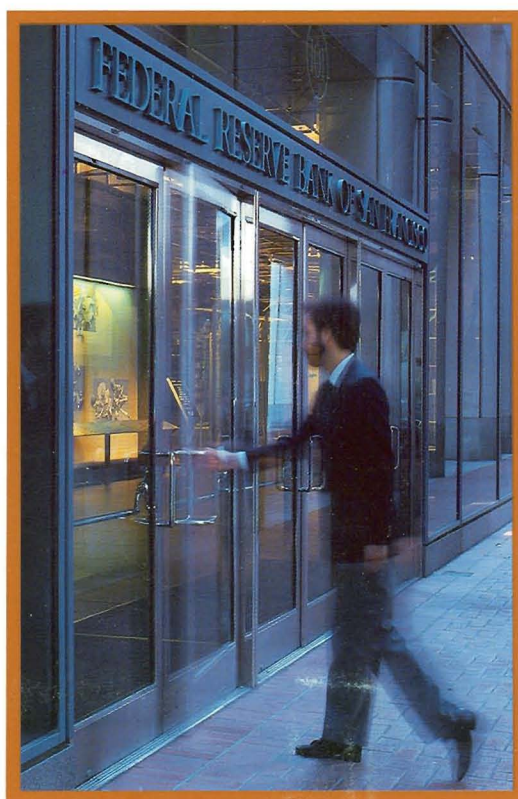


Federal Reserve Bank

San Francisco

# 1986 *Annual Report*



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The Federal Reserve Bank of San Francisco is one of twelve regional Reserve Banks which, together with the Board of Governors in Washington, D.C., comprise the nation's central bank. The Federal Reserve Bank of San Francisco serves the Twelfth Federal Reserve District, which includes Washington, Oregon, California, Arizona, Nevada, Utah, Idaho, Alaska, Hawaii, Guam and American Samoa.

As the nation's central bank, the Federal Reserve is responsible for determining and carrying out our nation's monetary policy. It also is a bank regulatory agency, a provider of wholesale priced banking services, and the fiscal agent for the United States Treasury.

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# From the Boardroom

Last year was a period of significant change for the Federal Reserve Bank of San Francisco. Foremost among the changes was new leadership.

John Balles, who served the Bank with distinction for more than 13 years as President and Chief Executive Officer, retired in January and was succeeded by Bob Parry. In August, Carl Powell was named First Vice President and Chief Operating Officer. Among other important management developments, Tom Thomson joined the Bank as a member of the Management Committee and Executive Vice President in charge of central bank functions, which include Economic Research and Public Information, Statistical and Data Services, and Supervision and Regulation. Finally, Tom Warren, also a member of the Management Committee and an Executive Vice President, moved to our Los Angeles Branch to lead the Bank's efforts in serving one of the nation's largest financial centers.

One important challenge to the Bank in 1986 was to continue providing high quality service while controlling costs in accordance with the Federal Reserve's decision to embrace the spirit of Gramm-Rudman budget cuts. To achieve the objective of spending less than called for by the Bank's approved budget for 1986, we restructured several functions and strengthened their management by adding individuals with proven expertise in cost controls. These moves, along with other initiatives that enhanced productivity, helped the Bank hold 1986 expenses 2.4 percent below budget.

Another challenge last year was the completion of several innovative technological projects that will form the foundation for better payments services for years to come. STAT, a package developed for the Federal Reserve System by the San Francisco Fed and now in place throughout the entire System, will process a broad spectrum of data provided by depository institu-

tions. A second nationally used system developed by San Francisco called SHARE was enhanced to handle new types of Treasury securities, including mortgage-backed securities. Two other systems implemented in 1986 — Treasury Direct and the Integrated Accounting System — advanced the Bank's capabilities to deliver service electronically and to provide more information in a timely fashion to our institutional and individual customers. In our priced payment services, expanded electronic access continued to be a major theme as we introduced new electronic products improving our Fedwire and Automated Clearing House capabilities.

The heightened efficiency and service capabilities afforded by advances in electronic banking are sometimes accompanied by new types of risks as well. Last year, the Federal Reserve System implemented new policies to restrict possible risks on large-dollar transfers of funds. Bank staff worked closely with employees of District institutions to ensure that the implementation of these policies was effective and appropriate for each institution.

Monetary policy is another vital area of responsibility for the Bank. In 1986, changes at the international as well as the domestic level created uncertainties for the policy environment. The large impact of foreign trade on the U.S. economic outlook led Bank economists to focus particular attention on the slow reaction of the U.S. trade deficit to the drop in the dollar. Uncertainties for the economic outlook were also created by the federal budget deficit and measures to control it and by the passage of tax reform legislation. Banking deregulation made the monetary aggregates a less reliable set of guideposts for policymakers. These uncertainties made the conduct of monetary policy more difficult than would have been the case in a more stable environment.

Supervisory and regulatory responsibilities were also conducted last year in a changing arena. District banking markets were substantially modified by the acquisition of Crocker National Corporation by Wells Fargo — the largest banking consolidation in U.S. history. Interstate banking became a prominent issue as, by the end of last year, every state in the District except Hawaii had passed legislation authorizing interstate acquisitions. To play our supervisory role most effectively, the Bank stepped up several aspects of its ongoing examinations of state member banks and bank holding companies.

Because of the large expanse of the Twelfth Federal Reserve District, the Federal Reserve Bank of San Francisco has developed a variety of ways to inform a geographically dispersed public about its policies and activities. Last year, the Bank expanded its public outreach to the District through an extensive program of speeches — including talks by the Bank's president, senior management, economists, and other head office and branch staff. Economic publications and videotapes produced by the Bank reached tens of thousands of people in the nation as well.

The Bank's branch offices play a special role in providing service to the District. Here, too, we saw a great deal of change — most notably in Los Angeles, where a new branch building to serve the West's most populous financial market neared completion. The new building will provide the ability to improve payments services to depository institutions in Southern California, Arizona, and Southern Nevada and will serve the public in other ways as well — by contributing to the revitalization of the surrounding South Park neighborhood, and by providing hands-on economic education through *The World of Economics* exhibition featured in the main lobby.



In meeting the challenges of 1986, management was particularly aided by the strong involvement and support of the Bank's Boards of Directors at its headquarters office and its branches in Los Angeles, Portland, Salt Lake City, and Seattle. We especially would like to extend our thanks and appreciation to the directors who completed their terms of service in 1986: Alan C. Furth, Chairman of the Head Office Board (Vice Chairman, Santa Fe Southern Pacific Corporation, and President, Southern Pacific Company, San Francisco), Harvey J. Mitchell, director of the Los Angeles Branch (President and Chief Executive Officer, Escondido National Bank, Escondido, California), Lola McAlpin-Grant, director of the Los Angeles Branch (Attorney, Inglewood, California), William S. Naito, director of the Portland Branch (Vice President, Norcrest China Company, Portland, Oregon), and Albert C. Gianoli, director of the Salt Lake City Branch (President and Chairman of the Board, The First National Bank of Ely, Ely, Nevada); as well as G. Robert Truex, Jr., our 1985-86 Federal Advisory Council Member (Chairman of the Board and Chief Executive Officer, Rainier Bancorporation, Seattle, Washington).

We also wish to thank the officers and staff of the Bank, who worked diligently to achieve a successful year. The professionalism and dedication of our almost 2,500 employees were critical elements in the Bank's success during 1986. Because the active involvement of people is especially crucial in an environment of rapid and widespread change, this *Annual Report* highlights the personal commitment of Bank employees in their role of serving the people and institutions of the Twelfth District. We fully recognize that it is only through the efforts of all who work here that success can be achieved.

Robert T. Parry  
President

Fred W. Andrew  
Chairman



**From left, Alan C. Furth, Chairman (1986), Fred W. Andrew, Chairman (1987), and Robert T. Parry, President.**



# Economic Research

The staff of economists at the San Francisco Reserve Bank, like their counterparts elsewhere in the System, provide economic analysis to the Bank's directors and president to assist them in carrying out their responsibilities in monetary policy and bank regulatory and supervisory matters. Policy analysis is used mainly in regular economic briefings for directors and related special presentations, as well as extensive briefings for the president before his participation at the Federal Open Market Committee, or FOMC — the body within the Federal Reserve responsible for making monetary policy.

At the core of the Bank's economic policy analysis is a program of basic research. By monitoring and analyzing national and regional developments, this program seeks to identify and explain the key economic issues monetary and regulatory policy need to address. The results of this research and policy analysis also form the core of the Bank's public information program, taking the forms of publications, speeches to outside groups, conferences, seminars, and audiovisual aids.

In addition, because of our unique position on the edge of the growing Pacific Basin economy, the Bank maintains a significant Pacific Basin program. Through meetings and exchanges of visitors, we foster closer ties among the central banks and governments of the region. We also pursue studies in the economies of the region, and we serve as a clearing-house for information provided by the region's central banks.

## Delay in Trade Improvements

Briefings for bank directors and the president on monetary policy in 1986 focused on key areas of uncertainty in the outlook for the national economy.

Foremost among those uncertainties was the influence of the trade deficit on economic growth. At the beginning of the year, most observers thought the foreign trade balance of the United States would improve substantially in response to the sharp 35 percent depreciation of the foreign exchange value of the dollar since early 1985, and give economic growth a major boost. The expected improvement did not take place, and a significant part of the Bank's analysis concentrated on understanding why. Whether the anomaly was permanent or temporary became a central issue in assessing the outlook for 1986-87.

Our analyses indicated that the disappointing performance of the trade balance was due to an important extent to a failure of imported goods prices to rise as fast as historical experience would have predicted, given the decline in the dollar's purchasing power abroad. However, new estimates of the relationship between the dollar and import prices, while not conclusive, suggested that import prices would at least partly catch up in subsequent years. In other words, an improvement of the trade account in response to the lower dollar, while it might be postponed, ultimately would occur.

The Bank's economic staff also analyzed the question of whether the increasingly important role played by imports to the U.S. from newly industrialized countries (NICs) in the Pacific Basin (such as Korea and Taiwan) could account for the unexpected behavior of the trade balance. The dollar had depreciated very little against these countries' currencies compared to those of our nation's traditional major trading partners (for example, West Germany and Japan). Our analysis, however, suggested that the dollar had declined enough to generate improvement in the trade picture even with the changes in our trading patterns.

## Deficit Reduction and Tax Reform

The uncertainties surrounding the efforts of Congress to come to grips with deficit reduction also clouded the outlook for 1986-87. Public discussion had focused to an important extent on the direct contractionary effects of lower government spending on economic activity. Our research drew attention to an *indirect* offsetting effect. We noted that lower federal budget deficits would reduce the need for capital imports and thereby take upward pressure off the dollar. The resulting improvements in the trade balance would stimulate the economy.

The impact of tax reform on the national economic outlook also received considerable attention. The research staff estimated that the sizable shift in the burden of taxation away from households towards businesses embodied in the reform would have roughly no net effect on economic growth over the two-year span 1987-88. However, tax reform would reduce economic growth in the first year by approximately one-half percent, and the economy would grow somewhat more rapidly in 1988 to make up the difference.

## Continuing Inflation Concerns

The forces shaping the inflation outlook in 1986 and 1987 also came under intensive scrutiny. Relatively lackluster growth over the past two years meant no significant wage and cost pressures at home; unremarkable growth left international developments — the collapse in the price of oil in 1986 and the substantial decline in the value of the dollar since 1985 — to be the key determinants of the inflation outlook.

Our estimates indicated that, in 1986, the upward cost pressures from the weaker dollar, and consequently more expensive imports, had been largely offset by the spectacular 58 percent decline in the price of oil between November 1985 and July 1986. However, the same estimates showed that almost all of the deflationary impact of a lower oil price would be over by 1987, whereas the decline in the dollar's value through 1986 would continue to feed inflationary pressures to the U.S. economy during 1987.

### **Monetary Analysis**

The Bank's economic research also focused on analyzing regulatory issues and their effects on the monetary aggregates used in making monetary policy. During 1986, the final steps were taken to phase out deposit interest rate ceilings at commercial banks and thrifts. The removal of virtually all deposit interest rate restrictions over the past six years opened the way for more people to earn rates of return comparable to market rates on their bank and thrift accounts.

At the same time, the key M1 monetary indicator (which includes all currency and fully checkable deposits held by the public) began to behave peculiarly, growing rapidly despite lackluster economic growth and moderate inflation. Whether or not deregulation was largely responsible, M1's usefulness as a monetary target and indicator was severely impaired. The Federal Reserve consequently de-emphasized the use of M1 as a guide to making monetary policy.

In this monetary policy environment, the question arose of whether deregulation had impaired the broader monetary aggregates — M2 and M3 — which encompass M1 but also include other types of accounts and instruments such as savings deposits and money market mutual funds. The issue was critical because the monetary aggregates provide an "anchor" for the Federal Reserve's long-run strategy of bringing down inflation and achieving reasonable price stability.

The Bank's economic research indicated that deregulation had not significantly compromised M2 and M3. Much of the rapid growth in M1 represented the transfer of funds from accounts and instruments that were in the broader M2 and M3 measures. Thus, while shifts of funds among various accounts had destabilized M1, they had left the broader totals relatively unaffected. This "stability" suggested that M2 and M3 were still useful monetary targets.

### **Deposit Insurance**

Complementing analytic work on the economic outlook and monetary policy, the Bank also studies developments in the banking industry, with a particular focus on issues in banking and regulatory and supervisory policy. One of these issues has been the increased number of bank failures in the 1980s, made more prominent last year by the highest number of failures since the Depression. We traced the increase in bank failures mainly to unforeseen changes in regional and international economic conditions, and concluded that the increase does not appear to be a result of deregulation as some critics of that policy have alleged.

Federal deposit insurance was another primary focus of banking research. The nation has been witnessing strong market pressures from both inside and outside the banking industry to erode the legislative walls that have separated commercial banking, investment banking, and commerce since the 1930s. Even within the legislated bounds of banking, banks increasingly have sought new markets through so-called "off-balance sheet" activities, which include loan commitments and letters of credit. And, with growing frequency, bank loans are packaged into securities that can be traded in financial markets.

Although the public stands to gain from these developments, the extensive insurance guarantee of the Federal Deposit Insurance Corporation raises the possibility that more and more financial activities could be insured either directly or indirectly by the federal government. Moreover, the serious funding problems of the Federal Savings and Loan Insurance Corporation (the government agency responsible for insuring savings and loan institutions) have made concerns about risks to the insurance funds even more pertinent.

Our research studies found that the present deposit insurance system helps protect against bank runs, but that the system also creates an incentive for insured institutions to lower their capital ratios, to increase the risk of their assets, or to choose other strategies that may increase the risk to the insurance funds. These studies also assessed proposed deposit insurance and banking regulation reforms intended to avoid the adverse incentives of our current system.



### Antitrust Policy

Ongoing research also examined the effects of the structure of banking markets on the conduct and performance of banks — an important issue in banking antitrust policy. One research project studied the effects of the level of competition on deposit rates paid by banks, and another looked at the effects of market concentration on the entry of banks into new geographic markets. These projects found evidence that banks tend to pay lower deposit rates, and new bank entry tends to be greater, in highly concentrated banking markets. This evidence suggests that profits may be somewhat higher than the competitive rate in these concentrated markets.

### Regional Research

A unique feature of the Federal Reserve System, with its network of regional Reserve Banks, is its ability to accumulate and analyze statistical data and other information obtained directly from the various regional economies in the United States. Because of the uneven patterns of economic activity across the nation during the 1980s, this "grassroots" information has proven to be particularly useful in recent years in helping the Bank form its views on monetary policy.

Last year, regional research focused on the divergent problems facing specific industries and states within the West. Our studies showed a positive turnaround in the forest products industry, and an aerospace industry that was bolstered by a pick-up in airline orders and a levelling of defense orders at a historically high level. On the negative side, the Alaskan economy and parts of the central California valley were hit hard by the drop in oil prices. Agriculture and agricultural lenders continued to fare poorly as well. The value of farmland continued to slide and the volume of problem agricultural loans at commercial banks and the Farm Credit Banks in the West grew sizably.

The semiconductor industry also is important to many of the western states, and it has been on a roller coaster ride over the past few years. A key issue for U.S. semiconductor manufacturers is the intense competition from Japan. Our research suggests that, given the nature of the industry and, to some extent, the cost advantages of Japanese producers, U.S. firms can expect little relief from stiff competition in the years ahead.

### Public Information

Like other Reserve Banks, we have a public information program that strives to enhance public awareness and understanding of the purposes, functions, and activities of the Federal Reserve System. Our program tries to provide the public with the information needed to understand and evaluate the conduct of monetary policy, regulatory actions, and other Federal Reserve responsibilities. We also support the public information activities of Bank management and other departments.

### Information and Education

The core of our public information program has always been the publication of economic research on important policy issues facing the U.S. economy and the Federal Reserve. Short articles by research economists on topical subjects written for a broad audience appear in the Bank's *Weekly Letter*, which has a circulation of 21,600, and reaches a larger audience through frequent newspaper citations and reprints. Our quarterly *Economic Review*, with 19,000 readers, complements the *Letter* by providing longer, more in-depth analyses.

Another way the Bank informs the public about economics is through *The World of Economics* exhibition, permanently installed in the lobby of our San Francisco office. Last year, this exhibition attracted about 14,000 visitors, including nearly 7,000 students who found the exhibition to be fun and informative. In 1986, the Bank completed plans to make the content of the exhibition accessible to the public in other areas of the Twelfth District. In the Los Angeles Branch, *The World of Economics* exhibition has been replicated almost in its entirety and will be open to the public in 1987. Both our Seattle and Portland Branches have planned to make two interactive computer games from the exhibition available to the public in portable units.

Audiovisual materials constitute another element of the Bank's economic information program. The monthly *Fed Views* program features interviews with Bank economists on major issues in the economy, and is designed primarily for our Branch directors and management. Last year, we added two more units to *The World of Economics Audiovisual Education Series* specifically designed for high school use — one on international trade and the second on the history of economic thought. Two earlier units focused on money's role in the economy and economic decision-making, respectively. The humorous approach used in the *Series* attracted more than 1,200 requests in 1986, and an audience conservatively estimated at around 30,000 students. When completed in early 1987, the *Series* will consist of six videotapes with matching curriculum materials. As more states mandate the study of economics in high school, the demand for educational materials such as our *Series* will continue to grow.

The Bank's tour program adds a personal dimension to our public information efforts. In 1986, 14,000 visitors toured the Bank's operational areas and viewed films and videotapes about the Federal Reserve and economic issues. Videotapes produced by the Bank that cover a wide range of economic issues also are shown regularly at open noontime screenings in the lobby auditorium in San Francisco.

### Media Outreach and Speeches

The media relations portion of our public information program both responds to inquiries from the press and supports the Bank's outreach to the public. During 1986, the bulk of media inquiries concerned the role of the Federal Reserve in regulatory and operation matters, especially the acquisition of Crocker National Bank by Wells Fargo, First Interstate's draft application to acquire Bank of America, and the new Treasury Direct program. Toward the end of 1986, we expanded media support for bringing the published writings and briefing documents of our economists to the attention of the press by establishing a program of direct contact with selected press.

Last year, our new president undertook an extensive public speaking program that required expanded media relations support. In about 30 speeches throughout most of the District, the president addressed business and community leaders, policymakers, and news media on topics that included the economic outlook, challenges to monetary policy, deposit insurance, and banking deregulation.

Other senior management and Bank staff gave about 120 speeches throughout the year, an increase of 10 percent from 1985. The groups addressed ranged from business forums and university audiences to legislative committees. Topics included fiscal and monetary policy, regional economics, challenges to deposit insurance, and the role of Federal Reserve Bank directors in system policymaking.

### Research Library

To help meet the Bank's own information needs, our Research Library offers current news and reference services to Bank staff that range from circulating a daily news packet and answering specific questions to providing in-depth support for ongoing projects. In 1986, the Library responded to nearly 1,800 in-house requests for information. Automation is a key component of this effort, and last year, the Library expanded both computerization of internal operations and use of online databases for reference searches.

The Library also plays a key role in public outreach by providing information about the Federal Reserve and its activities to audiences outside the Bank, including financial institutions, business and academic communities, government agencies, the media, and other libraries. In 1986, our librarians responded to about 3,400 such public requests. To answer common interest rate inquiries, 19,000 of which were received last year, we provide a recorded telephone message updated weekly. We also allow special use (by appointment) of our collection, which is regarded as one of the finest in economics and banking in the West and which includes unique materials on Pacific Basin countries.

### Branching Out

Our Branch offices play essential parts in the Bank's outreach to the Twelfth District by adapting District-wide materials to their own special needs, as well as by producing innovative programs of their own. In 1986, the Portland Branch co-sponsored with the Oregon Governor's Council of Economic Advisers a two-day symposium — "Oregon's Great Possibilities" — designed to encourage current and future economic growth in that state. The Salt Lake City Branch regularly invites representatives of various trade and business associations, such as members of Utah's import/export community, to join the Branch board of directors for lunch and a presentation by an economist or member of senior management following regularly scheduled board meetings.

In 1986, Seattle again offered "Inside the Fed," in which students from local universities simulated a meeting of the Branch board of directors with emphasis on the "economic go-around" in which directors exchange their economic views. Looking ahead, Los Angeles has planned a multi-faceted public information program, which makes use of *The World of Economics* lobby exhibition, to serve the most populous financial center in the West.



# Supervision, Regulation, and Credit

Promoting a sound financial system by supervising and regulating state member banks and bank holding companies is the central activity of our Supervision, Regulation, and Credit department. This involves, primarily, examining banking entities and processing applications for such activities as mergers and the establishment of bank holding companies and their international and domestic subsidiaries. Processing applications involves consultations with other Bank departments, especially Bank counsel and economic research, as well as meetings with the applicant and affected parties.

## General Improvement

Our examiners evaluate banks' assets, liabilities, organization, systems, and internal controls, and assess their compliance with banking laws and regulations. Last year, we found that most banks in our District improved the quality of their assets and maintained their profit margins. Credit problems were confined to a few institutions whose portfolios were dominated by loans to weak sectors of the economy, such as agriculture and energy. The number of commercial bank failures in our District increased to 13 (or about 10 percent of the national total) but involved a smaller volume of assets at \$461 million than the \$623 million high that resulted from 12 bank failures in 1984.

The results of each examination are reported to the senior management of the bank examined, to that bank's directors, and to the Board of Governors of the Federal Reserve. Where problems are identified, examiners recommend corrective actions. We had formal corrective programs in place at 31 bank holding companies and state member banks, down slightly from the 39 total for 1985, and we continued to work closely with other federal and state agencies in coordinating examinations and other supervisory activities. We also fostered increased participation by personnel

from state banking departments in various System examiner training programs conducted regionally.

## Enhanced Supervision

The Bank implemented a major initiative to strengthen bank supervision in 1986. The initiative called for increasing the frequency and scope of state member bank examinations and bank holding company inspections, and for improving the communication of examination findings to each institution's board of directors. The required additional staff and training activities were phased in over the course of the year, and will allow us to meet the full 1987 schedule planned for the initiative.

In another change implemented as part of the enhanced supervisory program, we emphasized the internal surveillance systems of bank holding companies and state member banks in evaluating their financial condition. The increased frequency of reports and the greater detail now available from regulatory reports filed by financial institutions permit us to incorporate more intensive analytical review into our pre-examination planning. In brief, we will be able to choose an institution whose reported data indicate a deterioration in its condition for earlier examination, and an institution with strong financial indicators for less frequent examination. We will be able to identify potential problems earlier and make a better allocation of staff.

Last year, we also incorporated changes in the formats of examination and inspection reports made by the Federal Financial Institutions Examination Council and the Board of Governors in our automation of report preparation and processing procedures.

## Mergers and Interstate Banking

The Bank processed a number of applications in 1986 that significantly altered the structure of major banking markets in the District. The most important was the application by Wells Fargo and Company to acquire Crocker National Corporation, which resulted in the largest consolidation of banking organizations in U.S. history.

Another significant development affecting applications was the movement of states to enact legislation permitting interstate commercial banking. By the end of 1986, all states in the Twelfth District, except Hawaii, had passed legislation authorizing interstate acquisitions of banks by out-of-state holding companies. We processed eight interstate applications, four of which were to acquire Arizona banks as institutions from other states moved to participate in the growth of Arizona's economy. The number of interstate acquisitions is expected to increase in 1987 when the regional provisions of California's new interstate banking law take effect.

The total volume of applications dropped slightly from that in 1985. The number of applications for new bank holding company formations decreased by almost 50 percent, confirming that the rapid movement during the early 1980s toward this form of bank ownership has subsided. Largely offsetting this decline was an increase in applications by our District's 329 bank holding companies for acquisition of banks and nonbanking companies as well as entry into new lines of business. The character of these applications suggests, however, that most bank holding companies have a cautious, selective attitude toward expansion.

International economic conditions in 1986 continued to restrain overseas expansion by District banks. The volume of international applications fell by one-third and most applications



*GEORGE WESTERMAN and JO MALINS, Review Analysts, Applications Unit, Supervision, Regulation, and Credit Department. George Westerman processed the application by Wells Fargo & Company to acquire Crocker National Corporation; the processing for this largest acquisition in banking history was completed in only 45 days. Jo Malins handled the proposal by Lloyd's Bank Plc to acquire Standard Chartered PLC — the fourth and fifth largest banking organizations, respectively, in Great Britain — which involved holdings of domestic banks.*

How would you describe the Review Analyst's job?

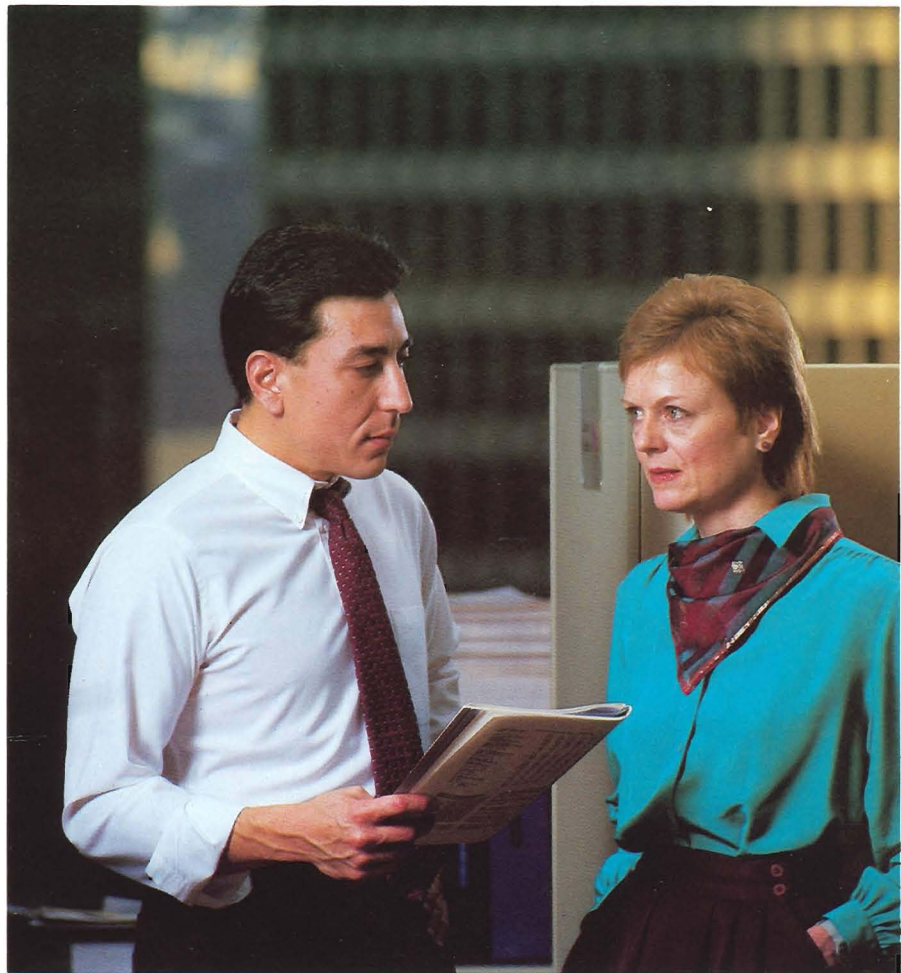
JM: I find the work a lot like case-work in business school. You look for acceptable variations of financial, managerial, legal, and competitive components. By acceptable, I mean consistent with statute and with policy set by the Board of Governors. The analyst doesn't do all of that, so the parallel to a "project manager" is also relevant. We're exclusively responsible for the financial and managerial analyses.

GW: I agree with Jo. We act as the central point in the coordination of all information flows, and produce the memorandum to the Board of Governors that contains the Bank's recommendation for action on an application.

What do you look for in an application?

GW: We have specific information requirements that enable us to evaluate the many aspects that Jo has mentioned. But, in a general sense, we review what an institution wants to do and ensures that the way it proposes to go about doing it is fundamentally sound.

JM: Often, the applicant's responses raise new questions involving financial, legal, or policy issues that need to be pursued and resolved.



Can you philosophize about the applications process?

JM: Certainly our mandate is to ensure the safety and soundness of banking, and, in that sense, I can do what I do with a sense of purpose. Safety and soundness in the public interest . . . I can get behind that.

Right now, bank holding companies are really driven by an entrepreneurial spirit; they want to be competitive with less regulated providers of financial services. We see proposals that are highly innovative, but, of course, as regulators, our level of risk aversion is much different.

GW: The application is basically a regulatory vehicle. We make sure that what happens in the banking industry happens in an orderly manner — one that is

consistent with banking law and System policies and guidelines.

However, the applications process is not adversarial. We're all in it together, and I feel we have a good rapport with the District's vast clientele.

But it's not so much what we do for the specific applicant. I feel it's mostly what we do to maintain public confidence in the banking system.

I get satisfaction just from being involved. I can come in at 7:30 some mornings and I'll already have a whole stack of phone messages because of the time difference with the East coast. That's the kind of stuff that really keeps me going. Crocker/Wells was the largest consolidation in U.S. banking history, and I was right there!



involved only minor additional investments or modifications to previously approved activities. No new export trading companies were approved during the year, and bank holding companies that had previously received approval for these companies continued to run them on a relatively small scale. Congress authorized export trading companies in 1982 to encourage U.S. exports, but the results to date have been disappointing largely because of the loss of export markets since that time.

### **Moderate Borrowing**

A key adjunct to our supervisory and regulatory responsibilities is the supply of needed liquidity to eligible depository institutions. Our Credit Unit also has responsibility for administering the Federal Reserve's policy on reducing the risk inherent in large-dollar transfers.

Borrowings for short-term adjustment credit and seasonal needs remained moderate throughout 1986. The number of borrowers accommodated at what is generally called the "discount window" decreased to 130 from 149 in the previous year. A number of smaller institutions continued to experience serious financial problems and received advances under the "other extended credit program" while they took other steps to improve liquidity. In several instances, advances from the discount window provided the time needed by regulators to arrange an orderly closure of failing institutions.

Total collateral pledged by Twelfth District institutions amounted to \$21.0 billion at the end of 1986, down from \$26.3 billion in 1985 due primarily to the merger of two large institutions and consolidation of their collateral.

### **Consumer Affairs**

In San Francisco, our Supervision, Regulation, and Credit Department also administers consumer credit laws and regulations and encourages community development and reinvestment through a community affairs unit. Consumer Affairs continued to provide advice to banks and information to consumers about the wide body of consumer protection laws and regulations. Our staff handled approximately 200 consumer complaints against state member banks last year, about the same number as in 1985. Nearly 20 percent of those complaints involved allegations of unauthorized withdrawals from automatic teller machines.

In a program begun in 1985, consumer affairs examiners conducted their regular compliance examinations with an increased reliance on "off-site" analysis of documents and records. This procedure permitted more thorough reviews in advance of examinations, especially at those banks growing quickly or experiencing problems.

### **Community Affairs**

Our Community Affairs function promotes the goals of the Community Reinvestment Act by assisting community groups and financial institutions in forming community development programs. This assistance can take the form of education as in our sponsorship of a major conference in 1986 to keep commercial bank compliance officers and attorneys informed of the standards expected under the Community Reinvestment Act. Assistance can also take the form of acting as a liaison or facilitator in resolving differences. On several occasions last year, Community Affairs and Bank counsel met with protest groups and applicants when bank merger applications raised controversial community issues. Other ways in which we assist the community development process include informational meetings with groups such as the Bay Area Urban Bankers Association and the provision of meeting facilities where planning for community development can take place.



**Management Committee**

(Seated, from left)

Thomas D. Thomson, Executive Vice President

Robert T. Parry, President

Thomas C. Warren, Executive Vice President

(Standing, from left)

Carl E. Powell, First Vice President

Michael J. Murray, Senior Vice President



# Bank Administration

The management of the San Francisco Reserve Bank continually strives to improve the efficiency and reliability of all Bank operations. Each year, senior management sets new objectives designed to meet and anticipate the developing needs of financial institutions, the federal government, and the general public in innovative ways.

During 1986, a new management team directed the completion of several major multi-year initiatives that will act as the foundation for delivering reliable, cost-effective services for years to come. These initiatives included automation efforts that embraced new software and new technology; the implementation of a Federal Reserve policy to reduce risk in the electronic transfer of large dollar payments; expansion of disaster contingency plans; and laying of new foundations in the form of a new building for the Los Angeles Branch.

Benefits from these initiatives will accrue to both the Bank and our customers. The Bank will benefit from greater flexibility and ease in its internal operations. Our customers and the public will receive more dependable, secure, and higher quality services. Already, the initiatives have helped the Bank hold 1986 expenses 2.4 percent below the budgeted level — a savings of nearly \$3.3 million — as part of our program to comply with the spirit of the Gramm-Rudman-Hollings balanced budget legislation. Looking ahead, the greater operating economies now available will enable us to tighten control over our expenses.

## Automation Efforts

Over the last several years, the Bank has completed a major automation program that has transformed the way we organize our operations, the services offered, and the technologies used. In the area of software development, we have focused primarily on developing and installing systems that were designed for use throughout the Federal Reserve System. Our computer operations area has also changed significantly. Whereas many functions involved batch processing in the past, they are now conducted on-line to provide better service to our large, geographically dispersed customer base.

We have devoted a great deal of attention to upgrading the Data Centers in our Head Office in San Francisco and our four Branches using uniform up-to-date technology; we have implemented an intradistrict data communications network; and we have centralized most major processing functions in San Francisco. In many respects, we have reached a plateau in our efforts, having established a stable automation and communications environment that meets current and anticipated future needs.

## Software Applications

The Bank staff that develops and supports business systems was particularly active in 1986 with the creation, installation, and maintenance of the eight critical software applications commonly used by the Federal Reserve System. San Francisco was the development site for two of those eight applications. The Banking Statistics Application (STAT), was completed in 1985 and installed in all other Reserve Banks and the Board of Governors in early 1986. STAT processes a wide range of data collected from depository institutions, including basic information some of which is used to compute the various money supply measures. The new system will significantly reduce the costs of maintaining the data and increase flex-

ibility in responding to changing data collection needs.

The automated securities handling system (SHARE) is the second application developed in San Francisco. Major enhancements to SHARE during 1986 included increasing its capacity to support the Treasury in its new securities offerings, such as mortgage-backed securities and discount notes.

In addition to developing software for the Federal Reserve System, San Francisco also installed several major software applications developed elsewhere. One of these, the Integrated Accounting System (IAS) is the new standard accounting application being installed throughout the Federal Reserve System. Culminating a three-year effort, IAS was successfully implemented on schedule in all five offices of this Bank. Implementation was accomplished with no major disruption to ongoing operations or customer services thanks largely to extensive planning, training, and pre-testing.

The three modules that make up the core of the IAS — Data Entry, General Ledger, and Deposit Accounting — are fully integrated with one another, unlike the systems they replaced. As a result, IAS has enabled the Bank to centralize and standardize the automated accounting functions for the District and thereby enhance our ability to incorporate changes while affording greater control of financial data. The use of IAS throughout the Federal Reserve System will ensure national consistency and compatibility in customer accounting services. IAS also provides the framework for the future electronic delivery of accounting information and will allow us to centralize our accounting functions further in support of cost-containment efforts. IAS will benefit depository institutions by helping the Federal Reserve meet the evolving needs of an interstate banking environment.



*TERRY LEJA, Employment Administrator, Personnel. In 1986, the Bay Area Urban Bankers Association awarded the Federal Reserve Bank of San Francisco its Bank of the Year Award for outstanding work with their organization. The Bank was also nominated for the Governor's Award for Employment of the Handicapped.*

What purposes does community outreach serve?

TL: It serves two purposes. First, the Personnel Department is continually seeking ways to increase our presence in the community in order to encourage people, especially minorities, females and the handicapped, to apply for positions at the Bank. One way we can do this is through our involvement with local organizations.

Second, it is our way of providing support to the community, especially for student groups and community organizations that need professional and administrative assistance. Basically, we want to be a good corporate citizen.

Would you give some examples?

TL: We've worked with the Bay Area Urban Bankers Association — a minority banking group that helps their adult members develop professionally and provides college scholarships for high school students. We hosted their scholarship reception last year at which Mr. Parry, the Bank's President, gave the keynote address. We were also a sponsor for their national affiliates' conference in the summer. We helped organize the conference, made our conference facilities available, and participated in a job fair. In recognition of this support we received the "Bank of the Year" award.

I serve on the Job Forum, which is a Chamber of Commerce panel made up of professionals in the Bay Area who give advice to job seekers. The Bank will be participating in the Bay Area Urban



League Job Fair, which focuses on employing minority students in high school and college.

Members of the Personnel Department also serve on several employers advisory boards for local colleges. I serve on San Francisco State University's Board, as a member of the workshop committee — assisting students in transferring their liberal arts degrees to the business world. We also seek to create a more positive image of the liberal arts degree in the employer's mind.

Another committee I'm involved with is the Community Volunteers Consultants Committee, affiliated with the Northern California Human Resources Council. We provide volunteer consulting services to nonprofit groups. For

example, we helped an Indian tribal group resolve some organization issues that subsequently helped them obtain funding.

How are you personally committed to what you do?

TL: One of the nice things about what I do is that I can take some personal feelings, personal commitments, and put them into action.

The Bank asks a lot from the community, and after all, the Bank is composed of people who live here, who work here, and who send their children to schools in the Bay Area. The people here at the Bank absorb a lot of the resources from the community; it is our responsibility to replenish some of these resources through our outreach efforts.



### **New Technology**

To meet the growing use of computer resources, the Bank upgraded its computer in the San Francisco Data Center with a central processor that makes use of state-of-the-art technology and which should serve the Twelfth District's needs for the next several years.

Along with developing new software and upgrading our data centers, the Bank has also emphasized the innovative use of computer-related technology. For example, we have established a substantial base of microcomputers that work in concert with our large mainframe processors. We are also expanding the use of somewhat larger computers dedicated to serving the needs of individual departments. The new Cash Automation System is one example of the successful use of such technology.

### **Payments Systems Risk**

The growing electronic sophistication of the financial industry has also posed some major risks to the nation's payments system. Last year, the Bank completed implementation of the Federal Reserve Board's policy to reduce risks on systems that transfer large-dollar payments. The new policy, which took effect March 27, 1986, calls for electronic transfer networks and individual institutions to limit the amount of credit risk they pose to the payments system.

Each institution that participates in a large-dollar funds transfer network, including the Federal Reserve's Fedwire service, is encouraged to adopt a cross-system net debit cap. The cap establishes an institution's maximum intra-day overdraft amount. An overdraft occurs when an institution wires out more funds than it has in its account with the Federal Reserve or when it sends more funds over a private funds transfer network than it has received. The cap is based on each institution's evaluation of its own creditworthiness, operational controls, and credit policies and procedures. The Federal Reserve, and other supervisory agencies, then review each institution's evaluation file during regular financial examinations.

During the year, the Bank worked with institutions throughout the District to ensure that appropriate steps were being taken to conduct evaluations and to establish caps limiting the level of intra-day overdrafts. We also incorporated a review of each institution's evaluation file into the Federal Reserve's regular financial examination program.

### **Disaster Contingency Planning**

A crucial part of any sound business practice is providing backup capability in case disaster disrupts regular operations. In 1986, through rigorous testing and documentation, we enhanced disaster contingency plans that call for locating the San Francisco data center to the Federal Reserve System's computer contingency site at Culpeper, Virginia and moving some critical operations to other Twelfth District Branch offices.

In San Francisco, the addition of technological improvements in service of the disaster contingency plan improved the Bank's emergency readiness. A new generator will allow the Head Office building to become energy self-sufficient should there be a local power outage. A Crisis Hotline, installed in San Francisco, will provide employees and their families current information on the status of Bank operations after a disaster. Finally, an emergency radio system will enable senior managers to communicate with the Bank and one another from their homes during any local telephone failure.

The contingency planning effort also was expanded to include the four Branch offices, where comprehensive plans were developed to provide critical services with efficient recovery from emergencies and long-term computer outages. Through its participation in the Earthquake Recovery Task Force of the California Bankers' Clearinghouse Association, the Los Angeles Branch joined a Bank emergency radio network in the Los Angeles Basin.

Together, these efforts enable us to minimize business interruptions and related costs and ensure the ongoing delivery of critical services to Bank customers in the event of short-term or long-term service disruptions.

# The New Los Angeles Building

After a decade of planning and three years of construction, the Bank neared completion of a new building for the Los Angeles Branch. Services provided by the Los Angeles Branch make it among the largest units in the Federal Reserve System; they include check processing, cash and fiscal operations, and bank supervision. The building will be fully occupied and dedicated in March 1987 in conjunction with the joint meeting of the Twelfth District Head Office and Branch Boards of Directors.

Within the District, the Los Angeles Branch serves about 4,000 depository institutions and their branches, handling the largest volume of federal tax deposits and processing over a billion dollars daily in its automated clearing house activities. The savings bonds operation in Los Angeles is the regional processing center for the Twelfth District in original issues over the counter, reissues, and redemptions. This operation puts the Los Angeles staff in contact with more U.S. savings bonds agents in a larger population base than any other District in the System.

The move into the new building began toward the end of the summer of 1986 with installation of computer equipment followed shortly by the relocation of check processing and related activities in October. Cash operations occupied the vaults and basement area prior to December.

In the short time that these large operating departments have occupied the new facility, the quality of services has improved dramatically. Adequate vault space, expanded operating areas,



and up-to-date equipment have increased the efficiency of Branch operations and boosted the morale of Branch employees.

Service reliability also has been vastly improved by the installation of a second computer that backs up the Branch's data processing capacity. In addition, service continuity during power outages was assured with the installation of emergency generators and an uninterruptable power supply.

The new facility plays a major role in the program of the Los Angeles Community Redevelopment Agency to revitalize the surrounding 100-acre South Park area. Designed by

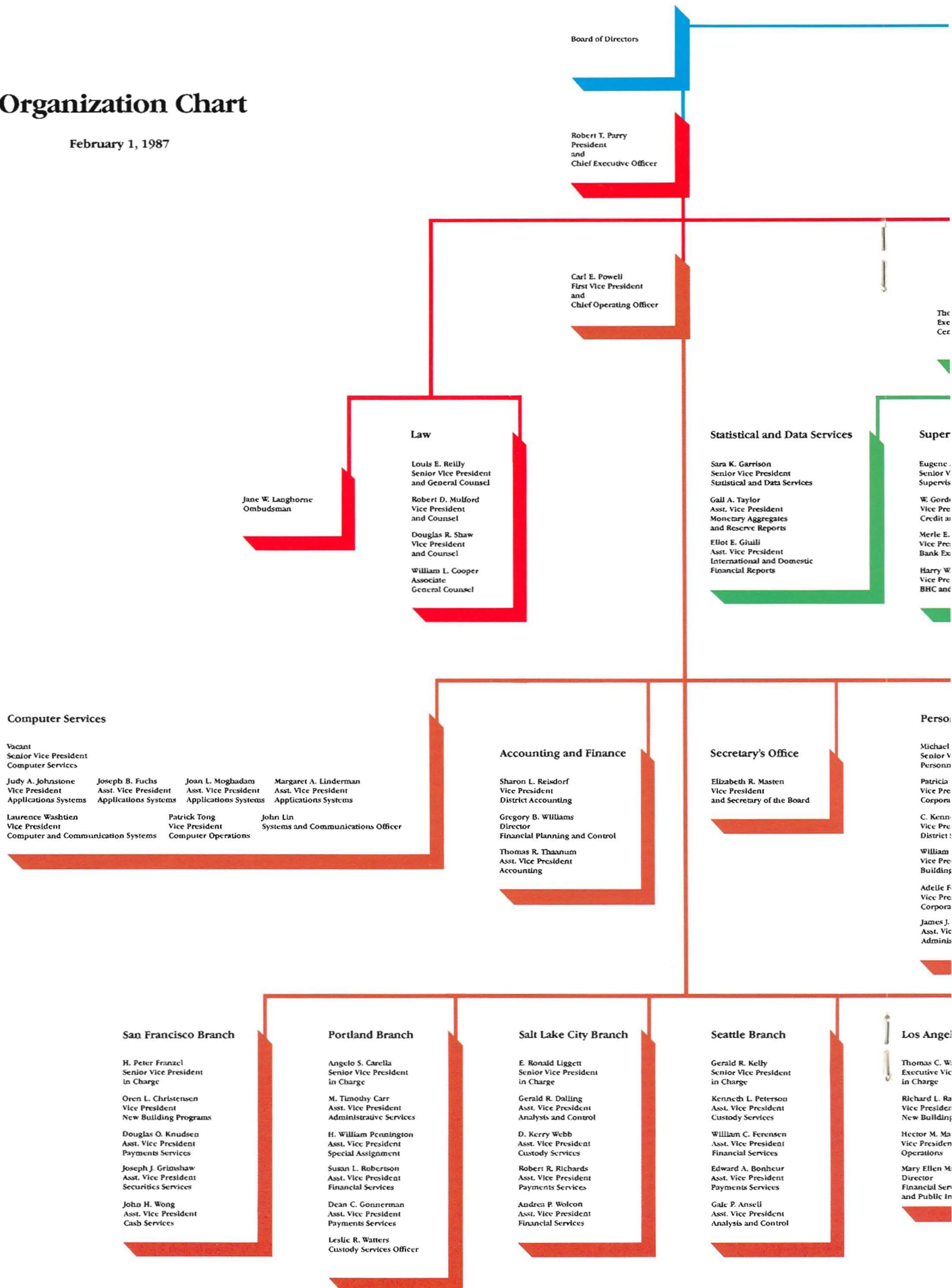
Dworsky and Associates, the structure stands out as a fine example of contemporary architecture. An undulating granite wall in the front of the building defines a graceful pedestrian arcade, and bows out toward the street to enclose a multi-storied skylit atrium containing the Branch's lobby.

*The World of Economics*, a major exhibition explaining economic principles and the workings of the U.S. economy, is featured in the main lobby. Open to the public, the permanent exhibition is a replica of one that has proven to be a highly popular and effective educational tool in the Head Office building in San Francisco.



# Organization Chart

February 1, 1987



## Auditing

Robert I. Gatchell  
General Auditor

Gul Gidwanj  
Assistant  
General Auditor

Peter K.C. Hsieh  
Audit Officer

Bruce H. Thompson  
Assistant  
General Auditor

Gary G. Hoeth  
Audit Officer

Charles O. Bowden  
Audit Officer

Thomas D. Thomson  
Executive Vice President  
Central Bank Functions

## Supervision, Regulation and Credit

Eugene A. Thomas  
Senior Vice President  
Supervision, Regulation and Credit

W. Gordon Smith  
Vice President  
Credit and Consumer Affairs

Donald R. Lieb  
Asst. Vice President  
District Credit

Wayne L. Rickards  
Asst. Vice President  
Bank and Consumer Regulation

David M. Vandre  
Consumer Affairs Officer

Merle E. Borchert  
Vice President  
Bank Examinations

Harold H. Blum  
Asst. Vice President  
Bank Examinations

Thomas P. McGrath  
Asst. Vice President  
Bank Examinations, S.L.C.

Robert C. Johnson  
Examining Officer

Thomas H. Gordon  
Examining Officer

W. Starr Seegmiller  
Examining Officer

Harry W. Green  
Vice President  
BHC and International Regulation

Robert A. Johnston  
Director  
Reports and Analysis

Kenneth R. Binning  
Asst. Vice President  
Applications

Rodney E. Reid  
Director  
BHC and International Supervision

Thomas J. Backer  
Examining Officer

Richard S. Campos  
Examining Officer

Philip M. Ryan  
Examining Officer

## Economic Research and Public Information

John L. Scadding  
Senior Vice President  
and Director of Research

John H. Beebe  
Vice President and  
Assoc. Director of Research

John P. Judd  
Vice President  
Domestic  
Macroeconomic Studies

Adrian W. Throop  
Research Officer

Hang-Sheng Cheng  
Vice President  
International Studies

John M.L. Gruenstein  
Vice President and Director  
Public Information

## Personnel and Administrative Services

Michael J. Murray  
Senior Vice President  
Personnel and Administrative Services

Patricia K. Lang  
Vice President  
Corporate Personnel

Sallie H. Weissinger  
Asst. Vice President  
Corporate Personnel

Dawn B. Allen  
Personnel Officer

Bobby A. Jeffery  
Personnel Officer

C. Kenneth Arnold  
Vice President  
District Security

William K. Ginter  
Vice President  
Building and Property Management

Adelle Foley  
Vice President  
Corporate Planning

John A. Trotter  
Planning Officer

Paige B. Scott  
Data Security and  
Contingency Planning Officer

James J. Tenge  
Asst. Vice President  
Administrative Services

Sylvia A. Cunningham  
Procurement Services Officer

## District Financial Services

John F. Hoover  
Senior Vice President  
District Financial Services

John W. Gleason  
Vice President  
Product Management

Buffintoo Clay Miller  
Vice President  
Product Management

Stephen A. Kaufman  
Asst. Vice President  
Electronic Payments

Barbara J. Contini  
Product Management Officer

Peter W. Homes  
Financial Services Officer

## Los Angeles Branch

Thomas C. Warren  
Executive Vice President  
in Charge

Richard L. Rasmussen  
Vice President  
New Building

Hector M. Martin  
Vice President  
Operations

Charles L. Huffstetler  
Director  
Cash Services, Accounting  
and Administrative Services

Brent M. Duxbury  
Asst. Vice President  
Administrative Services

Theodore A. Schroeder  
Asst. Vice President  
Securities Services

G. Bradley Snodgrass  
Checks Officer

Vacant  
Electronic Payments Officer

Mary Ellen Martin  
Director  
Financial Services, Installation Management  
and Public Information and Protocol





### **Branch Operations**

(From left)

Angelo S. Carella, Senior Vice President in Charge, Portland

Thomas C. Warren, Executive Vice President in Charge, Los Angeles

Gerald R. Kelly, Senior Vice President in Charge, Seattle

H. Peter Franzel, Senior Vice President in Charge, San Francisco

(Not available for photograph)

E. Ronald Liggett, Senior Vice President in Charge, Salt Lake City

# Priced Payments Services

The Federal Reserve in its role as a provider of wholesale banking services strives to promote the efficiency, safety, and soundness of the nation's payments system. To the average depositor, an efficient payments system means ready access to cash as needed and a shorter hold on deposited checks. To depository institutions, an efficient payments system means much the same: cash as needed to meet customer demands and the quick and reliable transfer of funds between accounts.

As required by the Monetary Control Act of 1980, many of our payments services are priced to encourage competition, and thereby greater efficiency, in the market for financial services. Approximately 1,500 depository institutions in the San Francisco Reserve Bank's District use one or more of the Bank's services. Electronic access to those services has proven particularly popular; we have over 1,200 terminals now in use at customer sites.

## Check Services

The Federal Reserve Bank of San Francisco handles the largest check volume of any District in the Federal Reserve System. In 1986, the number of individual checks processed for collection exceeded 2.5 billion. Moreover, moving checks in our nine-state district, which is roughly one-third the geographical size of the United States and spans five time zones, requires a highly sophisticated check transportation system. Given the substantial volume and complexity of our check collection system, we continually seek opportunities to improve service levels and quality.

Our success in meeting the needs of our diverse market is partially the result of extensive market research and listening and responding to customer concerns. During this past year, Bank representatives participated in numerous industry meetings and seminars to discuss current issues in

check collection, two of which stood out: the slow processing of dishonored or returned checks and the delayed availability of funds. "Delayed availability" is simply the number of days a bank holds a check before making the funds available to the depositor.

## Return Item Notification

Late in 1985, as part of our effort to respond to these payments system issues, we implemented the Large-Dollar Return Item Notification Service. This new service, which applies to checks in the amount of \$2,500 or more, provides a means of notifying the institution whose customer first deposits a "bad" check that the check has been dishonored. Because this notification must now take place within 48 hours, the new service has substantially improved the timeliness and reliability of the return item process.

In addition, we are developing automated systems to replace obsolete equipment used to process return items and checks rejected by high-speed sorters. The new systems will be operational in all our check processing centers by September 1987.

Finally, to help depository institutions understand our check collection process better, we have updated and simplified both our "Guide to Making Deposits" and "Adjustments" manuals. These newly designed publications will be ready for distribution early in January 1987.

Much of the success in our current check processing service is the result of our long-standing commitment to identifying the future needs of depository institutions. In this regard, we are a principal participant in a System-wide effort to explore new technologies for check and return item truncation. One new technology, called digital image capture, would enable us to record check information on computer files rather than

microfilm. Digital image processing could be a cost-effective and reliable means of transmitting, storing, and receiving check information. Studying the feasibility of new technologies helps us establish the methods that will lead to further efficiencies in the payments system.

## Electronic Payments

Our electronic payments services provide the means for transferring funds (or payments) from institution to institution or account to account via telephone lines and computers. One of these services is Fedwire, which is the Federal Reserve's funds transfer system providing same-day transfer of funds and settlement of payments. The Automated Clearing House (ACH) also provides for the electronic exchange and delivery of payments, but ACH payments transactions are processed in batches twice daily and settlement is made on a next-day basis. ACH has traditionally been used for high volume payments of low dollar amounts, such as payroll deposits or Social Security payments. Fedwire is more often used for high dollar transfers. Both the Fedwire and ACH services can be accessed in a variety of ways, including personal telephone contact, delivery of a magnetic tape, and computer connection.

## Fedwire

For our priced electronic payments services, we have put the emphasis on improving security and reliability, and have continued to promote the use of electronic access methods. Last year, we installed a new release of the Funds Transfer software that supports Fedwire, and nearly completed the encryption of our communications connections with all Fedwire customers. The encryption project, which started in the fourth quarter of 1984, will be completed in early January 1987. Our installation management team has made over 1,000 trips to depository institutions to deliver encryption boards and help with their installation.



*BARBARA TARRANT, Analyst, Installation Management. One of the major projects of Installation Management last year involved installing encryption for FedLine, On-line and computer interface connections in the District and conducting some limited on-site training at FedLine terminals. Barbara Tarrant was part of this group effort. In addition, she participated in the Bank's project team that developed the FedLine Check Returns product, resolved customer problems, and tested new software in support of the Bank's products.*

Describe what you do.

BT: I work with customers who use our microcomputer products, training them in the use of the products and helping them over the phone as well as on location when problems arise. Also I help develop new products; we give input to the design and testing of new products, and develop customer-oriented documentation. Installation Management is basically a support group to our customers and, internally, a development group.

Can you describe your relationship with the customers?

BT: Most of the time, we're dealing with people who use funds transfers — our main product. When they run into a problem transferring large sums of money they can panic, while we have to remain calm in helping them. To us, working with our products has become automatic, but we have to keep the customer's perspective in mind.

We also keep in mind that people with a wide range of expertise use our programs: anyone from clerks to VPs, depending on the size of the bank. In some small banks, five people make up the operations staff and everybody does everything. The training we provide must be appropriate for different levels of personnel.



Usually, our customers do not have a technical background. So in all our training programs we assume that the customer has never seen a PC before. Depending on the product, customers may come here to be trained or we send the product out with documentation. For the most part, the customers are anxious to learn and enjoy solving their own problems once they feel comfortable with our electronic services.

How do you want your customers to view you?

BT: I think the name "Federal Reserve Bank" scares a lot of people initially — they think it's a very formal organization. We represent

the Federal Reserve to a lot of these institutions, and for some of them, we're the only people at the Fed they ever deal with. So they come to us for help in areas not related to our electronic products too.

We joke with them, try to be friendly, not stuffy, and hope they see us as "real" people. I've been in Installation Management for four years and the number one rule is that the customer comes first. When a call comes in, it's answered at that time. We follow up on equipment problems even when it means going to different departments throughout the Bank. I think our customers feel we are thinking about them and meeting their needs.



Because service reliability must include predictable operating hours, we have made a concerted effort to reduce the number of days when Fedwire closing times are extended. We also continue to test and refine our contingency plan to ensure that the funds transfer system will operate even in the event of a crisis or natural disaster.

### ACH Improvements

Automated is the key word in ACH. Our consolidation in San Francisco of ACH processing for the Seattle, Portland and Salt Lake City branches gives us the opportunity to make some significant automation improvements to our services. For instance, our ACH staff in San Francisco and each of our consolidated Branches now has on-line access to information about customer transactions. This method of retrieving information means that we can respond more quickly to customer inquiries. In 1986, Los Angeles benefited from the installation of a new release of Systemwide ACH software.

The biggest improvements to our ACH service are those gained by customers who choose to access ACH electronically. In 1986, we introduced three electronic access products: FedLine ACH Return Items, FedCom, and Bulkdata. In early 1987, depository institutions will also be able to receive daily ACH transactions on FedLine.

FedLine ACH Return Items enables a customer to enter return items into a microcomputer and transmit them to us through a telecommunications connection. This method eliminates the physical paper return and associated item fee, and, since the delivery method is electronic, gives the customer more processing time to meet the ACH deadline.

FedCom and Bulkdata, both electronic access methods, enable a customer to send to or receive ACH transactions from us using a communications connection. Because we

offer a range of electronic access products, depository institutions of various sizes and varying degrees of computer sophistication can choose the access method that best suits their needs.

FedLine, a microcomputer system introduced in 1982 to allow a wider range of depository institutions direct access to the Bank's funds transfer system, continued to attract more customers. At the end of 1986, we had over 1,000 FedLine customers. FedLine's tremendous acceptance has enabled us to handle 99.8 percent of all funds transfer messages electronically.

### Cash Transportation and Securities Services

We also provide priced transportation services for currency and coin as a means of fostering efficient and safe access to cash. Because we act as a liaison between contracted carriers and depository institutions in the design of armored car routes, we are in a position to coordinate the cash

transportation needs of a number of depository institutions in one region. We are thus able to maintain favorable transportation costs and improve service to our customers, particularly those located in remote areas.

In early 1986, we established a cash terminal in Phoenix to consolidate cash shipments for many institutions, and thereby reduce costs and improve service levels for institutions throughout Arizona.

The Bank also offers a variety of securities services to depository institutions, including the safekeeping and transfer of book-entry (electronically recorded) securities issued by government agencies. These priced safekeeping services continue to grow at a fast pace. In 1986, we made improvements to the securities transfer service to handle mortgage-backed securities issued by Fannie Mae and Freddie Mac. We also developed several other features to improve our customers' backroom operations.

## Summary of Operations

	Volume (thousands)			
	1983	1984	1985	1986
<b>Custody Services</b>				
<b>Cash Services</b>				
Currency paid into circulation	1,925,085	2,188,831	2,438,168	2,651,545
Coin paid into circulation	5,078,150	5,302,832	4,773,270	4,980,392
<b>Securities Services</b>				
Savings Bonds original issues	1,235	1,549	2,019	2,821
Savings Bonds redemptions processed	285	279	293	231
Other Treasury original issues	116	138	108	63
Food Coupons processed	333,512	310,450	272,231	265,921
<b>Payments Services</b>				
<b>Check Services</b>				
Commercial checks collected	1,997,022	2,140,020	2,431,129	2,690,145
Government checks processed	96,136	95,548	93,451	91,458
Return items processed	24,707	35,580	28,800	31,239
<b>Electronic Payments Services</b>				
Wire transfers processed	8,671	10,361	11,457	12,632
Automated clearinghouse transactions processed	91,838	111,408	129,930	150,272
<b>Discounts and Advances</b>				
Total discounts and advances*	1,234	2,348	1,818	1,074
Number of financial institutions accommodated*	108	136	149	130

\*Whole number (not in thousands)



MARY CARRUTH PATRICK, *Product Planning Analyst, Product Management*. As a product planning analyst, Mary Patrick coordinates the development of new electronic access products that connect our customers to the Bank's FedLine products, which include Funds Transfer, Cash Ordering, UpDate Statements, UpDate Checks, ACH, and Check Returns. Mary Patrick leads the project team for FedCom ACH, one of the newest electronic access methods.

What do you consider the most important part of what you do?

MP: Communication is the most important part of my job because if I'm not communicating with people, the product we come out with may not fit anyone's needs or expectations. So I'm on the phone a lot — as you can see by the photo!

To determine what the customer wants, we start with data from customer surveys and information from Branch Financial Services staff who visit our customer institutions regularly. Sometimes we receive ideas directly from customers. In fact, customer feedback has resulted in built-in "help" screens and tutorials in the newer products.

Once we gather this information together, the Bank's Computer Services Group gives us a general understanding of the technical implications of potential products, and the various operating departments let us know how the product can be delivered. Installation Management, which provides customer training and on-going technical support, and Product Management work closely on new product development and on enhancing current products.

If our communication process is successful, both internally and with our customers, we find that each new product is a little better than the last.



What kinds of new products might we see?

MP: There is a big growth in the demand for tools which provide our customers timely, usable information about their activity with the Fed. Products that handle transaction data, such as a return item notification or a wire transfer, will still be important, but the need for ready access to informational services will increase rapidly.

Right now, we are taking a critical look at the FedLine/FedCom products we currently offer to identify any gaps in our product line and to determine if there are areas that may need improve-

ment. And we are continually looking at the technologies available to us for providing these products; these technologies may allow us to provide better, more timely information to our customers.

Now is a good time for our customers to think about what types of information they need that could be delivered electronically. And they should *communicate* that information to us.



# Governmental Services

The Bank is an important provider of fiscal and financial services to the United States government and to the public on behalf of the government. Our primary fiscal services to the U.S. Treasury include the issuing, servicing, and redemption of Treasury securities (Treasury bills and notes) and savings bonds, and the distribution of cash and coin to depository institutions. Additional financial services provided to government agencies include check collection and funds transfers, and the processing of electronic payments and food coupons.

## Securities Services

We achieved an important milestone in 1986 with the implementation of the *Treasury Direct* system in all five Twelfth District offices. *Treasury Direct*, developed jointly by the U.S. Treasury and the Federal Reserve System, allows individuals to hold their Treasury securities in their own book-entry safekeeping accounts. A book-entry account is simply an electronic record of transactions. The new system, which will ultimately maintain accounts for over two million investors throughout the country, provides comprehensive statements of account transactions. Principal and interest payments are made directly — electronically — to the investors' accounts at participating depository institutions.

Under *Treasury Direct*, engraved certificates will no longer be issued. All future U.S. Treasury marketable bills, notes, and bonds will exist only in book-entry form. Advantages to the *Treasury Direct* book-entry system include accurate and current transaction information, faster tracing of items, and no lost or misplaced Treasury certificates.

Most people will recall television news stories in late October 1986 of long lines of customers in cities throughout the country waiting to buy United States savings bonds just before the guaranteed interest rate was lowered from 7.5 percent to 6 percent. We too had our share of customers as we accepted applications for nearly 300,000 bonds in less than three days. That total was nearly four years' worth of normal volume! Ten weeks later, we completed processing all applications.

The new reduced guaranteed rate on savings bonds has not lowered the popularity of savings bonds as an investment alternative for many people. To accommodate the increasing volume of bonds purchased through payroll savings plans, the Bank has purchased additional equipment and is preparing to centralize the issuance of all payroll bonds on magnetic tape from the San Francisco office beginning in early 1987.

## Payments Services

The Federal Reserve is the largest processor of government checks in the United States and handled over 90 million of them in 1986. The San Francisco Reserve Bank collects, sorts, pays, and cancels all U.S. government checks deposited in financial institutions in the nine western states. We provide the Treasury Department with microfilm and magnetic tape records of all checks — a process known as truncation — and ship the cancelled items to a storage facility.

The Federal Reserve also serves as the chief agent for relaying electronic transfer payments, such as Social Security payments, from the government to individuals and business. We issue Treasury checks associated primarily with government securities transactions. As part of a Systemwide program to reduce the cost of processing government payments, we are preparing to use Federal Reserve checks in place of government checks for payments made on behalf of the U.S. Treasury. Our checks will be known as fiscal agency checks since we will be functioning as an agent for the U.S. government. This new program will be in place in all offices early in 1987.

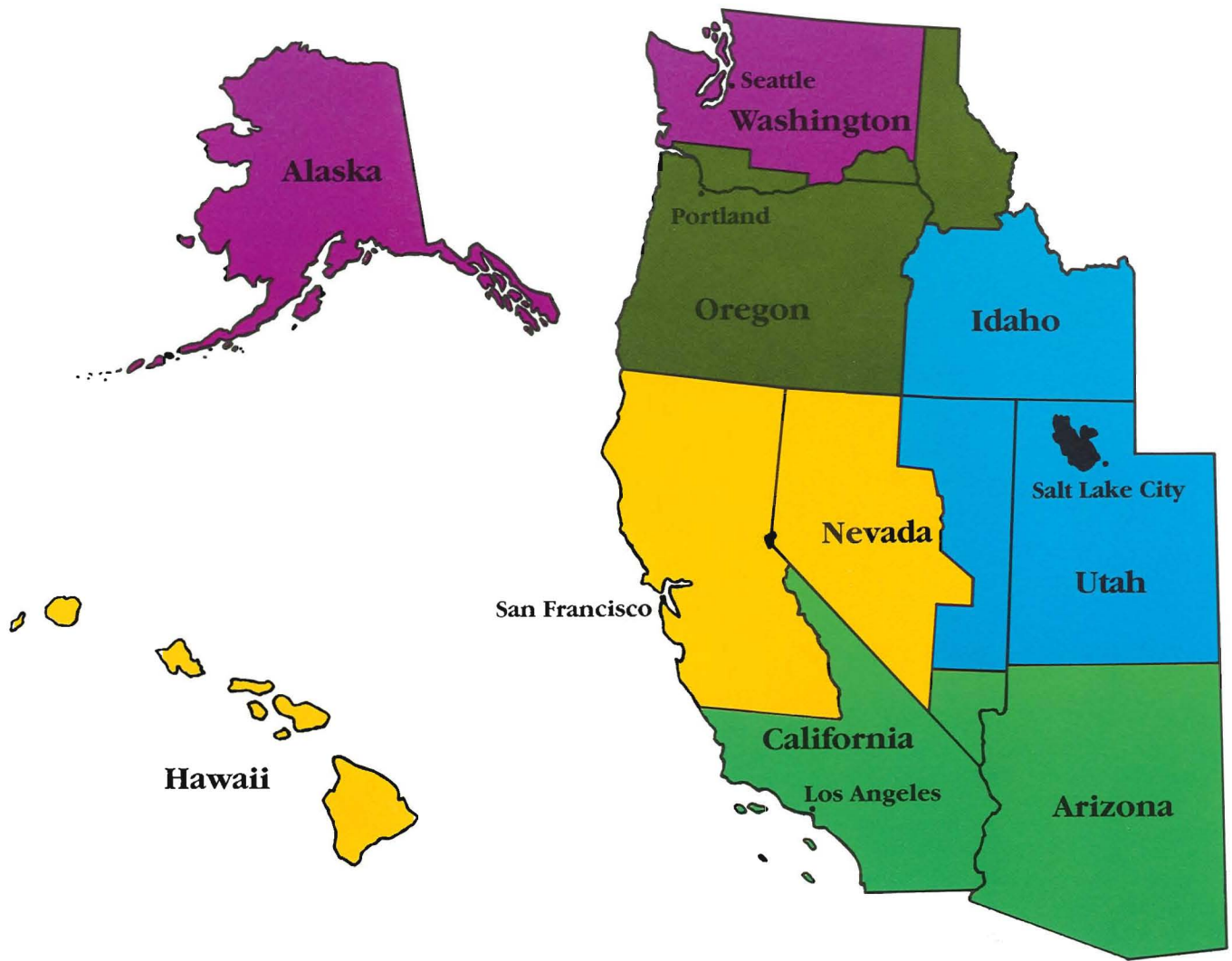
## Cash Services

The San Francisco Reserve Bank is responsible for distributing and circulating currency and coin to depository institutions throughout the nine western states. As such, we have the second highest cash processing volume in the System. To accommodate this high volume, we use high-speed equipment to count, sort, and verify currency deposits. These high-speed machines have dramatically increased the efficiency of our operations and raised the quality of currency in circulation.

During 1986, the Bank developed and installed a new Cash Automation System in all Branches. This minicomputer-based system provides automated record-keeping and accounting of all processing activities.

Looking ahead, we are working with other Reserve Banks to develop improved "second generation" currency processing equipment, and will continue to encourage the use of electronic systems.





## Twelfth Federal Reserve District

# Directors

Directors of the Federal Reserve bring management expertise to the task of overseeing Reserve Bank operations. They provide information on key economic developments in various areas of the District, complementing the Bank's internal research. In addition, Board members give advice on the general direction of monetary policy, especially with regard to the Bank's discount rates.

## Head Office

### Chairman of the Board and Federal Reserve Agent

Fred W. Andrew  
Partner  
Andrew & Williamson Sales Co.  
Bakersfield, California

### Deputy Chairman

Robert F. Erburu  
Chairman of the Board and  
Chief Executive Officer  
The Times Mirror Company  
Los Angeles, California

Carolyn S. Chambers  
President and Chief  
Executive Officer  
Chambers Communications Corp.  
Eugene, Oregon

Rayburn S. Dezember  
Chairman, President and  
Chief Executive Officer  
Central Pacific Corporation  
and Chairman  
American National Bank  
Bakersfield, California

Spencer F. Eccles  
Chairman, and  
Chief Executive Officer  
First Security Corporation  
Salt Lake City, Utah

Donald J. Gehb  
President and Chief  
Executive Officer  
Alameda Bancorporation and  
Alameda First National Bank  
Alameda, California

John C. Hampton  
President  
Willamina Lumber Company  
Portland, Oregon

Togo W. Tanaka  
Chairman  
Gramercy Enterprises, Inc.  
Los Angeles, California

George H. Weyerhaeuser  
President and Chief  
Executive Officer  
Weyerhaeuser Company  
Tacoma, Washington

### Federal Advisory Council Member

John D. Mangels  
Chairman  
Rainier National Bank  
and President  
Rainier Bancorporation  
Seattle, Washington



Andrew



Chambers



Eccles



Hampton



Weyerhaeuser



Erburu



Dezember



Gehb



Tanaka



Mangels





**Brown**



**Dockson**



**McCrady**



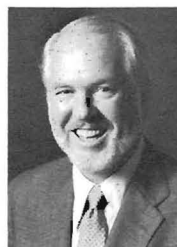
**Seaver**



**Burke**



**Jensen**



**Tooley**

## **Los Angeles**

### **Chairman of the Board**

Richard C. Seaver  
Chairman  
Hydril Company  
Los Angeles, California

Thomas R. Brown, Jr.  
Chairman of the Board  
Burr-Brown Corporation  
Tucson, Arizona

Yvonne Brathwaite Burke  
Senior Partner  
Burke, Robinson, Pearman  
Attorneys at Law  
Los Angeles, California

Robert R. Dockson  
Chairman  
CalFed, Inc.  
Los Angeles, California

Fred D. Jensen  
Chairman of the Board, President  
and Chief Executive Officer  
National Bank of Long Beach  
Long Beach, California

Howard C. McCrady  
Chairman of the Board  
Valley National Bank of Arizona  
Phoenix, Arizona

William L. Tooley  
Chairman  
Tooley & Company  
Investment Builders  
Los Angeles, California

## Portland

### Chairman of the Board

Paul E. Bragdon  
President  
Reed College  
Portland, Oregon



**Bragdon**

Herman C. Bradley, Jr.  
President and Chief  
Executive Officer  
Tri-County Banking Company  
Junction City, Oregon



**Bradley**

John A. Elorriaga  
Chairman and Chief  
Executive Officer  
United States National Bank  
of Oregon  
Portland, Oregon



**Elorriaga**

G. Johnny Parks  
Former Northwest Regional Director  
International Longshoremen's &  
Warehousemen's Union  
Portland, Oregon



**Parks**

Wayne E. Phillips, Jr.  
Vice President  
Phillips Ranch, Inc.  
Baker, Oregon



**Phillips**

Sandra A. Suran  
Partner  
Peat, Marwick, Mitchell & Co.  
Portland, Oregon



**Suran**

G. Dale Weight  
Chairman and Chief  
Executive Officer  
Benjamin Franklin Savings  
and Loan Association  
Portland, Oregon



**Weight**





**Christensen**



**Hanson**



**Pratt**



**Wheeler**



**Ence**



**Humphreys**



**Rose**

## **Salt Lake City**

### **Chairman of the Board**

Don M. Wheeler  
President  
Wheeler Machinery Company  
Salt Lake City, Utah

Gerald R. Christensen  
President and Chairman  
First Federal Savings  
& Loan Association  
Salt Lake City, Utah

Lela M. Ence  
Executive Director  
University of Utah Alumni  
Association  
Salt Lake City, Utah

Ronald S. Hanson  
President  
Zions First National Bank  
Salt Lake City, Utah

Fred C. Humphreys  
Director  
Moore Financial Group  
Boise, Idaho

Robert N. Pratt  
President  
Moriah Enterprises, Inc.  
Bountiful, Utah

D. N. "Nick" Rose  
President and Chief  
Executive Officer  
Mountain Fuel Supply Company  
Salt Lake City, Utah

## Seattle

### Chairman of the Board

John W. Ellis  
President and Chief  
Executive Officer  
Puget Sound Power & Light Company  
Bellevue, Washington



Ellis

H. H. Larison  
President  
Columbia Paint Co.  
Spokane, Washington



Larison

Byron I. Mallott  
Chief Executive Officer  
Sealaska Corporation  
Juneau, Alaska



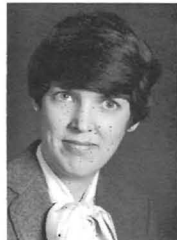
Mallott

John N. Nordstrom  
Co-Chairman of the Board  
Nordstrom, Inc.  
Seattle, Washington



Nordstrom

Carol Nygren  
Managing Partner  
Laventhol & Horwath  
Seattle, Washington



Nygren

W. W. Philip  
Chairman of the Board  
and President  
Puget Sound National Bank  
Tacoma, Washington



Philip

William S. Randall  
Chairman, President and  
Chief Executive Officer  
First Interstate Bank  
of Washington, N.A.  
Seattle, Washington



Randall



# Comparative Statement of Account

(Thousands of Dollars)

	December 31	
	1986	1985
<b>Assets</b>		
Gold certificate account . . . . .	\$ 1,470,000	\$ 1,361,000
Special Drawing Rights certificate account . . . . .	670,000	590,000
Other Cash. . . . .	106,026	83,682
Loans to depository institutions. . . . .	21,050	41,840
Federal Agency obligations . . . . .	1,091,697	1,103,353
United States Government securities:		
Bills . . . . .	14,470,075	11,456,076
Notes . . . . .	9,499,237	9,071,851
Bonds . . . . .	3,586,854	3,315,969
<b>Total United States Government Securities . . . . .</b>	<b>27,556,166</b>	<b>23,843,896</b>
<b>Total loans and securities . . . . .</b>	<b>28,668,913</b>	<b>24,989,089</b>
Items in process of collection . . . . .	1,544,691	1,607,278
Bank premises. . . . .	153,781	128,015
Operating equipment. . . . .	31,503	27,785
Other assets:		
Denominated in foreign currencies . . . . .	1,496,892	1,101,355
All other. . . . .	451,117	443,219
Interdistrict Settlement Account . . . . .	154,261	1,333,364
<b>Total assets . . . . .</b>	<b>34,747,184</b>	<b>31,664,787</b>
<b>Liabilities</b>		
Federal Reserve notes. . . . .	23,371,204	24,210,803
Deposits:		
Total depository institutions—reserve accounts. . . . .	9,037,467	4,979,368
Foreign. . . . .	23,700	23,550
Other deposits. . . . .	81,595	106,447
<b>Total deposits . . . . .</b>	<b>9,142,762</b>	<b>5,109,365</b>
Deferred credit items . . . . .	1,390,792	1,479,492
Other liabilities . . . . .	300,946	304,181
<b>Total liabilities . . . . .</b>	<b>34,205,704</b>	<b>31,103,841</b>
<b>Capital Accounts</b>		
Capital paid in . . . . .	270,740	280,473
Surplus. . . . .	270,740	280,473
<b>Total liabilities and capital accounts . . . . .</b>	<b>34,747,184</b>	<b>31,664,787</b>

# Earnings and Expenses

(Thousands of Dollars)

	December 31	
	1986	1985
<b>Current Earnings</b>		
Discounts and advances . . . . .	\$ 2,447	\$ 4,106
United States Government securities . . . . .	2,205,867	2,219,340
Foreign currencies . . . . .	62,188	35,859
Income from services . . . . .	72,767	69,524
All other . . . . .	1,997	1,740
<b>Total current earnings</b> . . . . .	2,345,266	2,330,569
<b>Current Expenses</b>		
Total current expenses . . . . .	136,643	128,391
Less: reimbursement for certain fiscal agency and other expenses . . . . .	12,314	10,589
<b>Net expenses</b> . . . . .	124,329	117,802
Cost of earnings credit . . . . .	7,853	7,711
<b>Current net earnings</b> . . . . .	2,213,084	2,205,056
<b>Profit and Loss</b>		
Additions to current net earnings		
Profit on sales of United State Government securities (net) . . . . .	9,193	12,967
Profit on foreign exchange transactions (net) . . . . .	311,360	189,977
Total additions . . . . .	320,553	202,944
Deductions from current net earnings		
All other . . . . .	5,692	1,268
Total deductions . . . . .	5,692	1,268
<b>Net additions ( + ) deductions ( - )</b> . . . . .	+ 314,861	+ 201,676
Assessments by Board of Governors		
Board expenditures . . . . .	- 14,937	- 12,150
Federal Reserve currency costs . . . . .	- 24,121	- 21,726
Net earnings before payments to the United States Treasury . . . . .	2,488,887	2,372,856
Dividends paid . . . . .	16,343	16,237
Payments to the United States Treasury (interest on Federal Reserve notes) . . . . .	2,482,277	2,331,636
Transferred to surplus . . . . .	- 9,733	24,983
Surplus, January 1 . . . . .	280,473	255,490
Surplus, December 31 . . . . .	270,740	280,473



**San Francisco Office**

P.O. Box 7702, San Francisco, California 94120

**Los Angeles Branch**

P.O. Box 2077, Terminal Annex, Los Angeles, California 90051

**Portland Branch**

P.O. Box 3436, Portland, Oregon 97208

**Salt Lake City Branch**

P.O. Box 30780, Salt Lake City, Utah 84125

**Seattle Branch**

P.O. Box 3567, Terminal Annex, Seattle, Washington 98124

This report was prepared by the staff of the Federal Reserve Bank of San Francisco: produced by Karen Rusk; graphics designed by William Rosenthal; edited by Gregory J. Tong. Assistance provided by Economic Research; Supervision, Regulation and Credit; and Corporate Planning, which coordinated the contributions of District Operations, Computer Services, Finance and Product Management, Statistical and Data Services and Personnel.

Federal Reserve Bank of San Francisco  
P.O. Box 7702  
San Francisco, California 94120

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